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SUBJECT: MADRID WEEKLY ECON/AG/COMMERCIAL UPDATE REPORT

MADRID 00000717 001.2 OF 002

ECON: State of Economy message - positive spin for Zapatero
EINV: Manuel Conte Apparently out Soledad Abad probably in at the CNMV
SENV: Spain struggles with Kyoto
EAGR/EINV: Cotton subsidies and DOHA

ZAPATERO EXTOLS SPANISH ECONOMIC SUCCESS AT MADRID STOCK EXCHANGE ON 04/16/07

¶1. (U) In what was billed by the GOS as the first annual "State of Economy" message, Zapatero praised the performance of the Spanish economy and released a report. He deliberately did not choose parliament as the venue for delivering the message as he reportedly wanted to avoid criticism from the opposition. Zapatero's Economic Office came up with this idea and based the initiative loosely on our annual "Economic Report of the President." Zapatero's Economic Adviser, David Taguas, is coming to the Embassy April 23 to brief the Ambassador and Econ Section on the report. Zapatero's speech was criticized widely in the Spanish press as too triumphalist and as not focusing on the vulnerabilities of the Spanish economy. The Financial Times 4/18/07 lead editorial title captures the essence of this criticism: "Vulnerable Spain's economy needs reform - It is not enough for Zapatero to celebrate economic success." As the FT points out, it is natural that Zapatero is trying to make political capital out of the continuing Spanish boom. But: "Keeping a lid on spending is a necessary but insufficient policy; in reality, the Socialists appear to see virtue in doing nothing." The FT posits that low eurozone interest rates, employment creation and the construction boom, coupled with very low productivity growth, a weak technology/education base, and the second largest current account deficit in the world is a dangerous combination. (Comment: The critics undoubtedly focus on the right economic factors, but, given that the IMF forecasts continued high growth in 2007 and 2008, Zapatero the politician is going to continue to extol the positive, even though he rejected "exaggerated optimism, because self-satisfaction is a conservative trait." The problem for the critics is that although they are unquestionably right that Spain's current growth model is not sustainable indefinitely, it appears to have some life in it yet. And the debate continues over how international events will spill over into Spain. One analyst suggests that in addition to European Central Bank interest rate hikes putting a damper on Spanish housing, the mortgage market in Spain will be affected by the fact that lenders are taking a second look at the vulnerabilities associated with the international securitization of mortgages - this analyst says mortgage lending in Spain in recent years has been made

possible by international securitization - in part because of what happened in the American sub-prime market, such securitization may be less available in the future. Again though, this risk does not appear to pose an immediate threat to the economy. (Financial Times, 4/18/07; Expansion, 4/16/07)

NEW NATIONAL SECURITIES MARKET PRESIDENT

12. (U) Speculation that Departing National Securities Market (CNMV - SEC equivalent) President Manuel Conte to be Replaced by Finance Minister Chief of Staff Soledad Abad: Abad is known to the Embassy as a hard-working and highly competent official. She is considered closer to Finance Minister Solbes than to President Zapatero. We have heard speculation from other sources as well that Abad might get the job. (Expansion, 4/18/07)

GREENHOUSE GAS EMISSIONS MAY HAVE FINALLY STOPPED GROWING

13. (SBU) Spain has been the EU's worst offender when it comes to compliance with the Kyoto Protocol. Spain's 2005 emissions were 52 percent above 1990 levels, while Kyoto calls for Spanish emissions to be no more than 15 percent over 1990 levels by 2012. But the steady growth of Spanish emissions may have finally peaked. According to a Spanish labor union/NGO study, Spanish greenhouse gas emissions in 2006 dropped from 52 above 1990 levels to 48 percent above 1990 levels. This drop, if confirmed by official Spanish Government figures, suggests that Spain's Kyoto compliance plan is not as wildly unrealistic as it first appeared. Spain's current plan calls for reducing emissions to 37 percent above 1990 levels by 2012. The other 22 percent reduction (required to reach the Kyoto target of 15 percent above 1990 levels by 2012), would come from buying emissions credits on the EU carbon market and from gaining carbon credits via development projects consistent with Kyoto's Clean Development Mechanism. Reasons for the reduction

MADRID 00000717 002.2 OF 002

include: nuclear power plants that suffered fewer service interruptions in 2006 versus 2005, higher than average rainfall that resulted in a greater contribution of hydro generated electricity, and the first indications that Spain's heretofore out-of-control electricity use growth rate may have finally stabilized. While there is a case to be made that Spain's greenhouse gas emissions are finally stopping to grow and leveling out, it is harder to demonstrate that serious reductions (e.g., to 37 percent above 1990 levels) can be obtained without significant changes to the Spanish electricity generation mix. The continuing move from oil to natural gas (combined cycle) plants will help, but will not, according to most observers, be enough in and of itself. The GOS is betting on an increased contribution from renewables, but its targets, if met, will not result in a significant drop in greenhouse gas emissions. Most observers believe that Spain will remain seriously out of compliance with the Kyoto unless it opts to construct more nuclear power plants. And that remains a political nonstarter, at least for now, for the Zapatero Government. Environment Ministry officials privately admit that Spain will never comply with Kyoto but underscore their willingness to induce economic pain to get Spain as close to compliance as politically possible.

DOHA AFFECTS COTTON EXPORTS

14. (U) In recent years, cotton production and export subsidies provided by "rich" industrialized countries have become the focal point for "us vs. them" negotiations on agricultural subsidies in the Doha Development Agenda Round of negotiations at the World Trade Organization. The European Union (EU) has effectively dodged the intense criticism showered on the United States because Europe was reforming its cotton subsidy policies.

15. (U) In response to that reform, Spanish cotton farmers

dramatically cut their production during Marketing Year (MY) 2006 (the first year of reform). Farmers reduced their plantings by about 25 percent, and harvested even less because they chose to minimize variable costs (fertilizer, irrigation, and weed control) leaving about 9,000 hectares un-harvested. As a result, during MY 2006 Spanish farmers produced and exported about 60 percent less cotton than the previous year. And, while it is too early to provide a definitive summation of MY 2007, we do expect that Spanish cotton farmers will continue to reduce harvested cotton area, resulting in less cotton to export to the world market where it would have competed with cotton grown by poor African farmers.

Aguirre